

**THE OFFICE OF REGULATORY STAFF
SURREBUTTAL TESTIMONY AND
EXHIBITS**

OF

WILLIE J. MORGAN, P.E.

OCTOBER 28, 2013



DOCKET NO. 2013-201-WS

**Application of Utilities Services of South
Carolina, Incorporated for Adjustment of
Rates and Charges**

SURREBUTTAL TESTIMONY AND EXHIBITS OF WILLIE J. MORGAN, P.E.

FOR

THE OFFICE OF REGULATORY STAFF

DOCKET NO. 2013-201-WS

IN RE: APPLICATION OF UTILITIES SERVICES OF SOUTH CAROLINA,

INCORPORATED FOR ADJUSTMENT OF RATES AND CHARGES

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND
OCCUPATION.**

A. My name is Willie J. Morgan, and my business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the South Carolina Office of Regulatory Staff (“ORS”) as the Program Manager for the Water and Wastewater Department.

**Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN
THIS PROCEEDING?**

A. The purpose of my surrebuttal testimony in this proceeding is to respond to specific portions of rebuttal testimony provided by Mr. Patrick Flynn, Mr. Mac Mitchell, Ms. Kirsten Markwell, and Mr. Steven Lubertozi for Utilities Services of South Carolina, Inc. (“USSC” or “the Company”). I will focus on the USSC rebuttal testimony related to:

- 1) The ORS revenue calculation;
- 2) USSC’s proposed Leak Mitigation Program;

- 1 3) ORS's classification of project expenditures as capitalized or
2 expensed;
3 4) ORS disallowance of costs for certain projects;
4 5) USSC's compliance with Commission Order No. 2013-77 regarding
5 the 10% cap on pass-through water supply charges; and
6 6) USSC compliance with Commission regulation 10 S.C. Code Ann.
7 Regs. 103-743.

8 **Q. DID ORS REVISE ITS TEST-YEAR REVENUE CALCULATION?**

9 A. Yes. My Exhibit WJM-2 contained an error in the revenue calculation for
10 one customer, Wikoff Color Corporation. I have corrected the calculation error
11 and Revised Exhibit WJM-2 reflects the test year revenue based on ORS's
12 review.

13 **Q. WHAT IS YOUR RESPONSE TO MR. FLYNN'S AND MS.**
14 **MARKWELL'S REBUTTAL TESTIMONY RELATED TO THE LEAK**
15 **MITIGATION PROGRAM PROPOSED BY UTILITIES SERVICES OF**
16 **SOUTH CAROLINA, INC.?**

17 A. The information provided in Mr. Flynn's rebuttal testimony is inconsistent
18 with the application filed by the Company. The application characterized the
19 Leak Mitigation Program cost as a continuous charge to its customers totaling
20 \$16,653 per year and lists it in the "General Expenses" category of the operating
21 expenses for USSC (USSC Application, Schedule B). The expense of the Leak

1 Mitigation Program is not known and measurable, and ORS made no adjustment
2 to include this pro forma expense in net operating income for return.

3 The original application did not provide a specific rate structure, program
4 administration details, or terms and conditions for the Leak Mitigation Program.
5 Neither Mr. Flynn nor Ms. Markwell offer in their rebuttal testimony any
6 historical data specific to USSC customers who have experienced an unexpected
7 high water bill due to a leak on the customer service line. ORS has received no
8 requests from customers for such relief in the most recent 12 months except a
9 recent inquiry concerning a line break caused by a cable company. Because the
10 Leak Mitigation Program as proposed by USSC is not based on known and
11 measurable statistics or actual costs, ORS recommends the Commission deny the
12 Company's request to fund the Leak Mitigation Program.

13 Through rebuttal testimony, Mr. Flynn reduced the amount of the Leak
14 Mitigation Program expense to .25% from the original 0.5% proposed in the
15 application; however, USSC did not propose to reduce the expense in its exhibits.

16 **Q. BASED ON THE PROCESS PRESENTED BY MR. STEVEN**
17 **LUBERTOZZI IN HIS REBUTTAL TESTIMONY, IS USSC IN**
18 **COMPLIANCE WITH ITS TARIFF PROVISION TO LIMIT THE**
19 **AMOUNT OF NON-ACCOUNT WATER CHARGED TO THE**
20 **CUSTOMERS?**

21 **A.** No. Based on the tariff approved by the Commission, customers should
22 not be charged for non-account water in excess of 10% of the total water

1 purchased from the bulk-water provider. Specifically, the current Commission
2 tariff requires the following:

3 The Utility shall limit the amount of non-account water charged to
4 customers not to exceed 10% of total water purchased from the
5 governmental body or agency, or other entity.
6

7 The method presented in Mr. Lubertozzi's rebuttal testimony is not
8 consistent with the tariff currently approved for USSC which requires the
9 Company to "limit" the amount passed through to the customer. It was ORS's
10 understanding that the customer would not be subject to a "true-up" as identified
11 by Mr. Lubertozzi and that the bills for water supply charges would be limited to
12 the 10% of total water purchased. Furthermore, the process presented by Mr.
13 Lubertozzi contains a timeframe for issuing credits to customers (i.e., next billing
14 period after the end of the six-month cycle or reduce the next vendor invoice by
15 the necessary amount). However, USSC has not followed its own developed
16 process. The 6-month billing period from the effective date of the current tariff
17 ended in July 2013 and no credit or refund had been returned to customers as of
18 October 17, 2013. The delay in crediting the customers erodes the validity of the
19 process. The delay also impedes the ability of USSC to ensure the appropriate
20 customer receives the credit or refund. The process description presented in Mr.
21 Lubertozzi's Exhibit SML-1 does not identify if USSC will be issuing customers
22 credits or refunds. In the section of Exhibit SML-1 that discusses the issuance of
23 credits, part of the language indicates that customers will be issued a credit while
24 the last two lines of the section gives reference to a refund.

1 One way to eliminate the issues of water loss and customer bill
2 comprehension is for USSC to pursue contract amendments with its bulk water
3 suppliers to allow USSC to bill the water supply charge based on the customer's
4 meter reading. USSC has such a contract structure with York County and it
5 ensures that non-account water generated by the distribution system is not passed
6 back to the customer. This type of contract amendment prevents USSC from
7 incurring the added expense of water loss associated with leaks and flushing.

8 **Q. WHY DOES ORS COMPUTE A CUSTOMER GROWTH ADJUSTMENT?**

9 A. ORS computes customer growth adjustment in each rate case to impute an
10 increase in test year revenues and expenses to reflect the average growth in the
11 number of customers during the test year and to ensure this average growth is
12 included in the rates to be set by the Commission. USSC experienced a small
13 amount of customer growth during the test year. While the actual number that
14 may be added to USSC's list of customers is uncertain in the future, the utility
15 experienced the addition of 14 water customers during the test year.

16 **Q. WHY DID ORS MAKE ADJUSTMENTS TO RECLASSIFY OR**
17 **DISALLOW EXPENDITURES RECORDED BY USSC AS CAPITALIZED**
18 **PLANT?**

19 A. It is ORS's position that if a utility replaces an existing capital asset,
20 installs or constructs a new asset, or extends the service life of an existing asset,
21 then the expenditures associated with those actions should be capitalized.
22 Further, it is ORS's position that expenditures associated with the day-to-day

1 operations of a utility should be expensed. This is consistent with ORS's
2 understanding of NARUC's Uniform System of Accounts process for
3 capitalization. ORS reviewed the USSC invoices related to capital projects and
4 determined (based on the description of the work and service location identified
5 on the various invoices along with information obtained from the site visits and
6 other responses provided by the Company) that USSC incorrectly classified
7 expenditures totaling \$1,874,861 as capitalized projects. These invoices were
8 identified by ORS as:

- 9 1) Routine expenses associated with day-to-day operations and
10 maintenance;
- 11 2) Equipment or asset not in service to the customer; and/or
- 12 3) Service or equipment that could not be verified by USSC as being used
13 to provide service to only USSC customers during the ORS site visit.

14 As a result, ORS either (1) reclassified these expenditures from capitalized
15 projects to operating and maintenance expenses or, (2) disallowed the expense
16 where the items were purchased outside of the test year. Examples of the
17 expenditures ORS reclassified to expenses for 2012 or disallowed include:

- 18 1) Minor repairs to water mains;
- 19 2) Minor repair/replacement of asphalt/concrete/landscaping;
- 20 3) Labor and supplies to raise water meter boxes; and
- 21 4) Cleaning of pumps used at sewer lift stations

1 A list of the invoices ORS reclassified from capitalized projects to
2 operation and maintenance expense or removed from capitalized projects are
3 attached as Surrebuttal Exhibit WJM-1. Surrebuttal Exhibit WJM-1 was created
4 by ORS from a report provided by USSC as part of the audit process. According
5 to USSC, the report provided to ORS was generated from the company's J.D.
6 Edwards accounting program ("JDE"). For reference, copies of the invoices ORS
7 reclassified or disallowed are included in Surrebuttal Exhibit WJM-2.

8 **Q. WHY DID ORS MAKE ADJUSTMENTS TO RECLASSIFY OR**
9 **DISALLOW CERTAIN INVOICES RECORDED BY USSC AS EXPENSES**
10 **DURING THE TEST YEAR?**

11 A. During the review of invoices associated with USSC's repair and
12 maintenance accounts, ORS identified several invoices classified as an expense
13 by USSC that should have been capitalized based on the nature of the service or
14 equipment purchased by USSC. In addition, several invoices were disallowed
15 from expenses because (1) the service or equipment was provided to another
16 Utilities, Inc. subsidiary (i.e. Carolina Water Service) or (2) ORS could not verify
17 that the service or equipment would only be used to provide service to USSC
18 customers. A list of the invoices ORS reclassified from operation and
19 maintenance expense to capitalized projects or disallowed from operation and
20 maintenance expense are attached as Surrebuttal Exhibit WJM-3. Surrebuttal
21 Exhibit WJM-3 was created by ORS from a report provided by USSC as part of
22 the audit process. According to USSC, the report was generated from the

1 company's JDE. For reference, copies of the invoices ORS reclassified or
2 disallowed are included in Surrebuttal Exhibit WJM-4.

3 **Q. EXPLAIN WHY THE "401" CODE IDENTIFIED BY USSC CANNOT BE**
4 **RELIED UPON AS AN ACCURATE METHOD TO ASSOCIATE AN**
5 **INVOICE TO A PURCHASE ORDER FOR USSC.**

6 A. In the supporting documentation for expenses, USSC provided numerous
7 invoices which did not contain a "401" code. The example provided by Ms.
8 Kirsten Markwell in KEM Exhibit I did not have the code identified on the
9 invoice. This invoice relates to the chemical expenses disallowed by ORS. After
10 several discussions with USSC, ORS was provided an ad hoc Purchase Order
11 voucher report from USSC that assisted in ORS's effort to cross-reference
12 purchase orders which contained the 401 code and the corresponding invoice.
13 ORS reviewed USSC's invoices a second time using the ad hoc Purchase Order
14 voucher report. This second review identified several invoices that did contain a
15 "401" code or Business Unit ("BU number") but were for activities unrelated to
16 USSC. An example of this type of invoice is contained in Exhibit – Mitchell 2
17 2009 Invoices, Bates stamped page 00023. This invoice is for services at a well
18 site for a Utilities, Inc. subsidiary, Carolina Water Service, Inc. ("CWS"). The ad
19 hoc Purchase Order voucher report lists a purchase order that connects this CWS
20 expenditure to USSC using the "401" code. ORS disallowed this invoice and
21 other invoices which were similarly miscoded.

Q. DO YOU AGREE WITH MR. PATRICK FLYNN THAT USSC IS NOT REQUIRED TO PROVIDE NOTICE TO ITS CALHOUN ACRES CUSTOMERS?

A. No. According to Mr. Flynn's rebuttal testimony, the current rates used by Sandy Springs Water Company in computing its charges for USSC is "based on a markup of 10% over the actual cost of water produced by the Anderson Joint Regional Water System, the source of Sandy Springs' water supply." However, Mr. Flynn does not include that there have been increases by the Anderson Joint Regional Water System. These increases raised the rates that Sandy Springs used in computing its bill for USSC. It is these increases that USSC should have provided notice of to the Commission and its customers prior to billing its customers for the increase. Specifically, USSC's tariff states:

The Utility shall give the Commission thirty days notice of its intent to pass-through to customers purchased water charges which are higher than those in effect at the time of the Commission's approval of the within rate schedule. The Utility shall provide with such notice written documentation of an increase by the provider of purchased water justifying the increase in the amount of purchased water charges sought to be passed-through to affected customers. In the event that an increase in the amount of purchased water charges to be passed through to customers rate is found by the Commission to be so justified, USSC will then be required to give customers an additional thirty days notice before the increase in the purchased water charges to be passed through may be put into effect.

Therefore, USSC is not in compliance with the provision of its tariff in Commission Order No. 2013-77 that requires USSC to provide notice to the

1 Commission and USSC's customers prior to any increases in bulk water charges
2 passed on to customers through the pass-through provision of the tariff.

3 **Q. SHOULD USSC OBTAIN APPROVAL FROM THE COMMISSION FOR**
4 **ALL BULK WATER CONTRACTS?**

5 A. Yes. Under the Commission's regulations, USSC is required to obtain
6 approval for all of its bulk water service contracts. Specifically, 10 S.C. Code
7 Ann. Regs. 103-743 requires the following:

8 No utility shall execute or enter into any agreement or contract
9 with any person, firm, partnership, or corporation or any agency of
10 the Federal, state, or local government which would impact,
11 pertain to, or effect said utility's fitness, willingness, or ability to
12 provide water service, including but not limited to the treatment of
13 said water, without first submitting said contract in form to the
14 commission and the ORS and obtaining approval of the
15 commission.
16

17 As stated in my direct testimony, USSC did not obtain Commission approval for
18 the bulk water supply contracts it entered into for the following locations:
19 Towncreek Acres, Indian Cove, Charleswood, and Farrowood subdivisions. Even
20 though bulk water is only used to supplement the water produced from USSC's
21 wells, the Commission's regulations require that the contracts be approved by the
22 Commission.

23 **Q. DOES THAT CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

24 A. Yes.